

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type <input type="checkbox"/> County <input type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Unit Name Hillsdale Board of Public Utilities	County Hillsdale
Fiscal Year End 6/30/06	Opinion Date 8/3/06	Date Audit Report Submitted to State 10/10/06	

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

YES NO **Check each applicable box below.** (See instructions for further detail.)

1. ☒ ☐ All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2. ☒ ☐ There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3. ☒ ☐ The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4. ☒ ☐ The local unit has adopted a budget for all required funds.
5. ☒ ☐ A public hearing on the budget was held in accordance with State statute.
6. ☒ ☐ The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7. ☒ ☐ The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8. ☒ ☐ The local unit only holds deposits/investments that comply with statutory requirements.
9. ☒ ☐ The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10. ☒ ☐ There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11. ☒ ☐ The local unit is free of repeated comments from previous years.
12. ☒ ☐ The audit opinion is UNQUALIFIED.
13. ☒ ☐ The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14. ☒ ☐ The board or council approves all invoices prior to payment as required by charter or statute.
15. ☒ ☐ To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)		
Financial Statements	<input checked="" type="checkbox"/>			
The letter of Comments and Recommendations	<input checked="" type="checkbox"/>			
Other (Describe)	<input type="checkbox"/>			
Certified Public Accountant (Firm Name) Willis & Jurasek, P.C.		Telephone Number 517-788-8660		
Street Address 2545 Spring Arbor Road, Suite 200		City Jackson	State MI	Zip 49203
Authorizing CPA Signature <i>Roger Mack, CPA</i>		Printed Name F. Roger Mack		License Number 1101020342

Hillsdale Board of Public Utilities

Financial Report
With Supplemental Information

June 30, 2006

Independent Auditors' Report.....	i-ii
-----------------------------------	------

Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	iii
---	-----

Basic Financial Statements

Financial Statements:	
Statement of Net Assets.....	1
Statement of Revenues, Expenses and Changes in Net Assets.....	2
Statement of Cash Flows	3
Notes to Financial Statements.....	4-11

Supplemental Information

Electric Fund:

Statements of Net Assets	12
Statements of Revenues, Expenses and Changes in Net Assets.....	13
Schedules of Operating Expenses	14

Water Fund:

Statements of Net Assets	15
Statements of Revenues, Expenses and Changes in Net Assets.....	16
Schedules of Operating Expenses	17
Schedules of Bonded Debt.....	18-19

Sewer Fund:

Statements of Net Assets	20
Statements of Revenues, Expenses and Changes in Net Assets.....	21
Schedules of Operating Expenses	22
Schedule of Bonded Debt.....	23



Independent Auditors' Report

Board Members
Hillsdale Board of Public Utilities
Hillsdale, Michigan

We have audited the accompanying financial statements of the business-type activities and each major fund of the Hillsdale Board of Public Utilities, Enterprise Funds of the City of Hillsdale, Michigan, as of and for the year ended June 30, 2006, which collectively comprise the Board's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Hillsdale Board of Public Utilities' management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 1, the financial statements present only the Hillsdale Board of Public Utilities Enterprise Funds and are not intended to present fairly the financial position of the City of Hillsdale, and the changes in its financial position and cash flows of its proprietary fund types in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and each major fund of the Hillsdale Board of Public Utilities as of June 30, 2006, and the respective changes in financial position and cash flows thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated August 3, 2006, on our consideration of the Board's internal control over financial reporting and on our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

WILLIS & JURASEK, P.C.

2545 Spring Arbor Road
Post Office Box 39
Jackson, Michigan 49204-0039

Phone Number: (517) 788-8660
Fax Number: (517) 788-9872
E-mail: willis@willispc.com
Web site: www.willispc.com

Board Members
Hillsdale Board of Public Utilities

The Hillsdale Board of Public Utilities has not presented Management's Discussion and Analysis (MD&A) as required supplementary information that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be, part of the financial statements. The Hillsdale Board of Public Utilities has elected not to prepare such analysis, but encourages users of these financial statements to read the MD&A contained in the annual financial report of the City of Hillsdale for the year ended June 30, 2006.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Hillsdale Board of Public Utilities basic financial statements. The accompanying supplemental information, as identified in the table of contents, is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The current year supplemental information has been subjected to the auditing procedures applied in the audit of the basic financial statements, and, in our opinion, is fairly stated in all material respects, in relation to the basic financial statements taken as a whole.

A handwritten signature in cursive script that reads "Willis & Jurasek, P.C.".

Willis & Jurasek, P.C.

August 3, 2006



**Report on Compliance and on Internal Control
Over Financial Reporting Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

Board Members
Hillsdale Board of Public Utilities
Hillsdale, Michigan

We have audited the financial statements of the Hillsdale Board of Public Utilities as of and for the year ended June 30, 2006, and have issued our report thereon dated August 3, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Hillsdale Board of Public Utilities' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance

As part of obtaining reasonable assurance about whether the Hillsdale Board of Public Utilities' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended for the information of management, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Willis & Jurasek, P.C.

Willis & Jurasek, P.C.

August 3, 2006

Hillsdale Board of Public Utilities
Statement of Net Assets
June 30, 2006

	<u>Electric</u>	<u>Water</u>	<u>Sewer</u>	<u>Total Business Type Activities</u>
Assets:				
Current assets:				
Cash and cash equivalents	\$ 1,372,143	\$ -	\$ 370,181	\$ 1,742,324
Receivables:				
Customer accounts, net of allowance for doubtful accounts of \$120,000	1,041,101	69,506	72,313	1,182,920
Interest	12,619	2,804	4,346	19,769
Due from other funds of BPU	-	-	1,001,735	1,001,735
Due from other funds of City	17,506	-	-	17,506
Inventories	637,762	80,122	6,577	724,461
Prepaid expenses	<u>81,656</u>	<u>20,177</u>	<u>32,892</u>	<u>134,725</u>
Total current assets	<u>3,162,787</u>	<u>172,609</u>	<u>1,488,044</u>	<u>4,823,440</u>
Restricted and designated assets:				
Designated investments	2,118,218	234,959	278,357	2,631,534
Restricted investments	<u>-</u>	<u>633,871</u>	<u>591,990</u>	<u>1,225,861</u>
Total restricted and designated assets	<u>2,118,218</u>	<u>868,830</u>	<u>870,347</u>	<u>3,857,395</u>
Capital assets:				
Property, plant and equipment, at cost	29,183,273	9,962,770	13,265,101	52,411,144
Less: accumulated depreciation	<u>16,955,419</u>	<u>4,157,629</u>	<u>8,899,369</u>	<u>30,012,417</u>
Total capital assets (net)	<u>12,227,854</u>	<u>5,805,141</u>	<u>4,365,732</u>	<u>22,398,727</u>
Other assets:				
Investment in M.S.C.P.A.	<u>4,463,715</u>	<u>-</u>	<u>-</u>	<u>4,463,715</u>
Total assets	<u>21,972,574</u>	<u>6,846,580</u>	<u>6,724,123</u>	<u>35,543,277</u>

See Notes to Financial Statements.

	<u>Electric</u>	<u>Water</u>	<u>Sewer</u>	<u>Total Business Type Activities</u>
Liabilities:				
Current liabilities payable from current assets:				
Accounts payable	\$ 63,964	\$ 9,825	\$ 18,519	\$ 92,308
Accrued purchased power	809,582	-	-	809,582
Due to other funds of BPU	-	1,001,735	-	1,001,735
Due to other funds of City	45,815	2,530	2,946	51,291
Customer deposits	7,069	500	-	7,569
Accrued liabilities:				
Payroll taxes	5,318	-	-	5,318
Other	35,072	7,245	7,343	49,660
Total current liabilities payable from current assets	<u>966,820</u>	<u>1,021,835</u>	<u>28,808</u>	<u>2,017,463</u>
Current liabilities payable from restricted assets:				
Bonds payable	-	250,000	145,000	395,000
Accrued interest	-	35,476	6,100	41,576
Total current liabilities payable from restricted assets	-	285,476	151,100	436,576
Compensated absences payable	82,690	35,148	36,936	154,774
Long-term debt, net of current maturities:				
Bonds payable	-	3,085,000	935,000	4,020,000
Total liabilities	<u>1,049,510</u>	<u>4,427,459</u>	<u>1,151,844</u>	<u>6,628,813</u>
Net Assets:				
Invested in capital assets, net of related debt	12,227,854	2,470,141	3,285,732	17,983,727
Restricted for debt service	-	633,871	591,990	1,225,861
Unrestricted (deficit)	<u>8,695,210</u>	<u>(684,891)</u>	<u>1,694,557</u>	<u>9,704,876</u>
Total net assets	<u>\$ 20,923,064</u>	<u>\$ 2,419,121</u>	<u>\$ 5,572,279</u>	<u>\$ 28,914,464</u>

Hillsdale Board of Public Utilities
Statement of Revenues, Expenses
and Changes in Net Assets
Year Ended June 30, 2006

	<u>Electric</u>	<u>Water</u>	<u>Sewer</u>	<u>Total Business Type Activities</u>
Operating Revenue:				
Sales to customers:				
Residential	\$ 3,245,416	\$ 451,790	\$ 442,896	\$ 4,140,102
Business	944,680	113,458	109,287	1,167,425
Commercial	2,556,697	215,425	228,140	3,000,262
Industrial	3,074,207	108,495	135,059	3,317,761
Apartments	-	220,589	221,876	442,465
Street light sales	35,198	-	-	35,198
Other operating income	<u>40,211</u>	<u>4,761</u>	<u>14,577</u>	<u>59,549</u>
 Total operating revenue	 <u>9,896,409</u>	 <u>1,114,518</u>	 <u>1,151,835</u>	 <u>12,162,762</u>
Operating Expenses:				
Purchased power	6,604,746	-	-	6,604,746
Production expense	889,504	50,336	-	939,840
Transmission and distribution	995,361	-	-	995,361
Collection system expense	-	-	202,332	202,332
Treatment expense	-	-	508,912	508,912
Purification expense	-	205,935	-	205,935
Distribution expense	-	399,876	-	399,876
Administrative and general	<u>752,007</u>	<u>223,519</u>	<u>241,364</u>	<u>1,216,890</u>
 Total operating expenses	 <u>9,241,618</u>	 <u>879,666</u>	 <u>952,608</u>	 <u>11,073,892</u>
Operating Income	<u>654,791</u>	<u>234,852</u>	<u>199,227</u>	<u>1,088,870</u>
Non-operating Revenue (Expense):				
Interest income	71,761	16,567	49,234	137,562
Interest expense	-	(144,380)	(23,700)	(168,080)
Other non-operating income (expense)	<u>2,804</u>	<u>(7,756)</u>	<u>(4,168)</u>	<u>(9,120)</u>
 Total non-operating revenue (expense)	 <u>74,565</u>	 <u>(135,569)</u>	 <u>21,366</u>	 <u>(39,638)</u>
Changes in Net Assets	<u>729,356</u>	<u>99,283</u>	<u>220,593</u>	<u>1,049,232</u>
Net Assets, Beginning of Year	<u>20,193,708</u>	<u>2,319,838</u>	<u>5,351,686</u>	<u>27,865,232</u>
Net Assets, End of Year	<u>\$ 20,923,064</u>	<u>\$ 2,419,121</u>	<u>\$ 5,572,279</u>	<u>\$ 28,914,464</u>

See Notes to Financial Statements.

Hillsdale Board of Public Utilities

Statement of Cash Flows

Year Ended June 30, 2006

	Business-Type Activities - Enterprise Funds			
	Electric	Water	Sewer	Total
Cash Flows from Operating Activities				
Cash received from customers, residents and users	\$ 9,868,676	\$ 1,115,682	\$ 1,143,864	\$ 12,128,222
Other operating receipts	40,211	4,761	14,577	59,549
Cash paid to employees and suppliers	(9,191,560)	(631,395)	(803,690)	(10,626,645)
Net cash provided by operating activities	717,327	489,048	354,751	1,561,126
Cash Flows from Capital and Related Financing Activities				
Bond payments on capital debt	-	(245,000)	(140,000)	(385,000)
Interest payments on capital debt	-	(144,380)	(24,400)	(168,780)
Purchase of capital assets, net	(990,678)	(91,109)	(40,312)	(1,122,099)
Net cash used by capital and related financing activities	(990,678)	(480,489)	(204,712)	(1,675,879)
Cash Flows from Investing Activities				
Unrealized gain on investments	64,954	17,452	(13,789)	68,617
Purchase of investments	(99,734)	(35,019)	-	(134,753)
Other non-operating income received	2,799	-	-	2,799
Other non-operating expenses	-	(7,756)	(4,171)	(11,927)
Interest income received	70,830	16,764	49,234	136,828
Net cash provided by investing activities	38,849	(8,559)	31,274	61,564
Net Increase (Decrease) in Cash and Cash Equivalents	(234,502)	-	181,313	(53,189)
Cash and Cash Equivalents, Beginning of Year	1,606,645	-	188,868	1,795,513
Cash and Cash Equivalents, End of Year	<u>\$ 1,372,143</u>	<u>\$ -</u>	<u>\$ 370,181</u>	<u>\$ 1,742,324</u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities				
Operating income	\$ 654,791	\$ 234,852	\$ 199,227	\$ 1,088,870
Adjustments to reconcile operating income to net cash provided by operating activities				
Depreciation	640,934	209,848	156,789	1,007,571
(Increase) decrease in:				
Receivables	17,622	6,414	6,606	30,642
Due from other funds	(12,008)	-	(25,090)	(37,098)
Inventories	4,374	4,929	(2,132)	7,171
Prepays	(2,049)	(2,550)	(2,288)	(6,887)
Investment in M.S.C.P.A.	(581,702)	-	-	(581,702)
Increase (decrease) in:				
Accounts payable	30,305	167	10,566	41,038
Accrued expenses	(53,593)	10,684	11,247	(31,662)
Due to other funds	22,925	25,193	(174)	47,944
Customer deposits	(4,272)	(489)	-	(4,761)
Net Cash Provided by Operating Activities	<u>\$ 717,327</u>	<u>\$ 489,048</u>	<u>\$ 354,751</u>	<u>\$ 1,561,126</u>

See Notes to Financial Statements.

Hillsdale Board of Public Utilities

Notes to Financial Statements

Note 1 – Summary of Significant Accounting Policies

The financial statements of the Hillsdale Board of Public Utilities (BPU) have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP), as applicable to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the government's accounting policies are described below.

Reporting Entity

The Hillsdale Board of Public Utilities (the BPU) provides electric, water and sewage disposal services to residents of the City of Hillsdale (the City) and nearby townships, as recorded in three separate enterprise funds. Policy is set and operations are directed by a five-member Board.

Measurement Focus and Basis of Accounting

The BPU uses funds to report on its financial position and the results of its operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts.

The operations of the BPU are accounted for as Enterprise Funds of the City of Hillsdale, Michigan, which are designed to be self-supporting. Enterprise Funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the cost of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and the resulting net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The BPU reports the following major proprietary funds:

Electric – This fund accounts for the activities of the BPU's electric generation and distribution systems.

Water – This fund accounts for the activities of the BPU's water production, purification and distribution systems.

Sewer – This fund accounts for the activities of the BPU's sewer collection and treatment systems.

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All enterprise funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of these funds are included on the balance sheet. Proprietary fund-type operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in net total assets.

The accrual basis of accounting is utilized by enterprise funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance of their business-type activities and enterprise funds, subject to this same limitation. The government has elected not to follow subsequent private-sector guidance.

Hillsdale Board of Public Utilities

Notes to Financial Statements

Note 1 – Summary of Significant Accounting Policies (Continued)

Measurement Focus and Basis of Accounting (Continued)

Proprietary funds (enterprise funds) distinguish *operating* revenues and expenses from *non-operating* items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the BPU enterprise funds are charges to customers for sales and services. The BPU also recognizes as operating revenue the portion of fees intended to record the cost of connecting new customers to the system. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Cash, Cash Equivalents and Investments

Cash and cash equivalents include cash on hand, demand deposits and certificates of deposits with original maturities of three months or less from the date of acquisition.

State statutes authorize the BPU to invest surplus funds in bonds, securities, other obligations of the United States, or an agency or instrumentality of the United States; repurchase agreements; certificates of deposit, savings accounts, deposit accounts or depository receipts of a qualified financial institution; commercial paper rated at the time of purchase within the two highest classifications established by not less than two standard rating services and that matures not more than 270 days after the date of purchase; bankers' acceptances of United States banks; obligations of the State of Michigan or any of its political subdivisions that, at the time of purchase, are rated as investment grade by at least one standard rating service; mutual funds registered under the Investment Company Act of 1940 with the authority to purchase only investment vehicles that are legal for direct investment by a public corporation; and external investment pools as authorized by Public Act 20 as amended through December 31, 1997.

Investments are stated at fair value.

Short-term Interfund Receivables/Payables

During the course of operations, numerous transactions occur between individual funds for goods provided or services rendered. These receivables and payables are classified as "due from other funds" or "due to other funds" on the balance sheet.

Receivables

All receivables are reported at their net value. They are reduced, where appropriate, by the estimated portion that is expected to be uncollectible.

Inventories and Prepaid Items

Inventories are valued at cost, which approximates market, using the average cost method. Certain payments to vendors reflect costs applicable to future fiscal years and are recorded as prepaid items.

Hillsdale Board of Public Utilities

Notes to Financial Statements

Note 1 – Summary of Significant Accounting Policies (Continued)

Capital Assets

Capital assets which include land and buildings, plant, vehicles and equipment, and infrastructure assets (e.g., pipes, poles, wire, transformers, and similar items) are reported in the business-type activities column in the government-wide financial statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Major outlays for capital assets and improvements are capitalized when projects are completed.

Property, plant, and equipment of the BPU is depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Plant and systems	10-65

Net Assets

Certain proceeds of enterprise fund revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the balance sheet because their use is limited by applicable bond covenants. Restricted resources are applied first when an expense is incurred for which both restricted and unrestricted net assets are available. Restricted net assets segregate resources accumulated for debt service payments. Designations of net assets represent tentative management plans that are subject to change.

Interfund Transactions

Quasi-external transactions are accounted for as revenues or expenses. Transactions that constitute reimbursements to a fund for expenses initially made from it that are properly applicable to another fund, are recorded as expenses in the reimbursing fund and as reductions of expenses in the fund that is reimbursed.

Use of Estimates

The process of preparing financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenditures. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

Pension Plan Funding

The BPU policy is to fund pension costs as they accrue.

Compensated Absences

Accumulated unpaid vacation, sick, and personal days are accrued when earned.

Hillsdale Board of Public Utilities
Notes to Financial Statements

Note 2 – Cash and Investments

A summary of cash and investments at year-end is as follows:

Bank deposits (checking and savings accounts and short-term CDs)	\$1,741,724
Investments	3,857,394
Cash on hand	<u>600</u>
	<u>\$5,599,718</u>

Investments are further specifically identified as of year-end, as follows:

	<u>Amount</u>	<u>Rating</u>
Fidelity Investment Cash	\$ 15,237	N/A
Spartan U.S. Government Money Market	656,796	N/A
U.S. Government Agency Bonds (maturing in 1 to 5 years)	3,085,035	AAA
Certificate of deposit (maturing in 464 days)	<u>99,326</u>	N/A
	<u>\$3,857,394</u>	

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Board's deposits may not be returned. The Board has not adopted and State law does not require a policy for deposit custodial credit risk. As of year-end, \$1,488,782 of the Board's bank balance of \$1,697,877 was exposed to custodial credit risk because it was uninsured and uncollateralized.

Custodial Credit Risk – Investments

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Board will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Board has not adopted and State law does not require a policy for investment custodial risk.

Interest Rate Risk

State law limits the allowable investments and the maturities of some of the allowable investments as identified in the list of authorized investments above (see Note 1). The Board's investment policy does not have specific limits in excess of State law on investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The maturity dates for each investment type are identified above for investments held at year-end.

Credit Risk

State law limits investments to specific government securities, certificates of deposits and bank accounts with qualified financial institutions, commercial paper with specific maximum maturities and ratings when purchased, bankers' acceptances of specific financial institutions, qualified mutual funds and qualified external investment pools as identified in the list of authorized investments above (see Note 1). The Board's investment policy does not have specific limits in excess of State law on investment credit risk. The ratings for each investment are identified above for applicable investments held at year-end.

Hillsdale Board of Public Utilities

Notes to Financial Statements

Note 3 – Capital Assets

Capital asset activity for the year was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Disposals and Adjustments</u>	<u>Ending Balance</u>
Business-type activities:				
Capital assets not being depreciated:				
Land	\$ 189,982	\$ -	\$ -	\$ 189,982
Construction in progress	<u>232,266</u>	<u>252,861</u>	<u>117,194</u>	<u>367,933</u>
Total capital assets not being depreciated	<u>422,248</u>	<u>252,861</u>	<u>117,194</u>	<u>557,915</u>
Capital assets being depreciated:				
Plant and systems	50,889,788	986,431	22,990	51,853,229
Accumulated depreciation:				
Plant and systems	<u>29,027,837</u>	<u>1,007,570</u>	<u>22,990</u>	<u>30,012,417</u>
Total capital assets being depreciated, net	<u>21,861,951</u>	<u>(21,139)</u>	<u>-</u>	<u>21,840,812</u>
Business-type activities capital assets – net	<u>\$ 22,284,199</u>	<u>\$ 231,722</u>	<u>\$ 117,194</u>	<u>\$22,398,727</u>

Depreciation expense was charged to operating expenses as follows:

Electric Fund	\$ 640,934
Water Fund	209,848
Sewer Fund	<u>156,788</u>
	<u>\$ 1,007,570</u>

Note 4 – Investment in Michigan South Central Power Agency

The Michigan South Central Power Agency (M.S.C.P.A) was organized in 1978 under the authority of Michigan Public Act 448 of 1976, to supply electricity to member municipalities in South Central Michigan. The Act provides that the agency will establish rates and charges to produce revenues sufficient to cover its costs, but may not operate for profit, except for the benefit of the public. The agency is governed by a Board of Commissioners which is comprised of one representative from each participating municipality and the general manager of the agency.

Participating municipalities and their respective shares of ownership are as follows:

	<u>Percent Of Ownership</u>
City of Coldwater	40.0%
City of Hillsdale	25.5
City of Marshall	24.0
Village of Clinton	6.5
Village of Union City	<u>4.0</u>
	<u>100.0%</u>

Hillsdale Board of Public Utilities
Notes to Financial Statements

Note 4 - Investment in Michigan South Central Power Agency (Continued)

The Hillsdale Board of Public Utilities is accounting for its investment in M.S.C.P.A. as a joint venture in accordance with Governmental Accounting Standards Board Statement No. 14. Information presented below is taken from financial statements of the M.S.C.P.A. for the year ended June 30, 2006, audited by other auditors, whose report dated August 10, 2006, expressed an unqualified opinion on those statements.

The BPU has entered into a Power Sales Contract with M.S.C.P.A. which requires the BPU to purchase all of its bulk power supply from M.S.C.P.A. and to pay its share of M.S.C.P.A.'s operating and debt service costs. The BPU has also entered into an agreement for services to be provided by the M.S.C.P.A. in respect to substation facilities and an agreement which requires the BPU to sell to M.S.C.P.A. power generated by its facilities.

The summary information of the BPU investment in the M.S.C.P.A. for the year ended June 30, 2006 is as follows:

	<u>Total M.S.C.P.A.</u>	<u>Hillsdale BPU Portion 25.5%</u>
Total assets	\$ 76,241,628	\$ 19,441,615
Total liabilities	<u>58,736,861</u>	<u>14,977,900</u>
Net Assets	<u>\$ 17,504,767</u>	<u>\$ 4,463,716</u>
Operating revenues	\$ 44,961,391	\$ 11,465,155
Operating expenses	<u>37,275,616</u>	<u>9,505,282</u>
Operating Income	7,685,775	1,959,873
Other income and expenses	<u>(5,404,589)</u>	<u>(1,378,170)</u>
Changes in Net Assets	2,281,186	581,702
Net Assets, Beginning of Year	<u>15,223,581</u>	<u>3,882,013</u>
Net Assets, End of Year	<u>\$ 17,504,767</u>	<u>\$ 4,463,715</u>

Hillsdale Board of Public Utilities

Notes to Financial Statements

Note 5 - Long-Term Debt

Long-term liabilities for the BPU's three enterprise funds for the year ended June 30, 2006, are as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Business-type activities:					
Revenue bonds:					
1999 Water	\$ 1,960,000	\$ -	\$ 105,000	\$ 1,855,000	\$ 110,000
2002 Water					
Refunding	1,620,000	-	140,000	1,480,000	140,000
1992 Sewer	<u>1,220,000</u>	<u>-</u>	<u>140,000</u>	<u>1,080,000</u>	<u>145,000</u>
	4,800,000	-	385,000	4,415,000	395,000
Compensated absences	<u>139,923</u>	<u>14,851</u>	<u>-</u>	<u>154,774</u>	<u>-</u>
Total	<u>\$ 4,939,923</u>	<u>\$ 14,851</u>	<u>\$ 385,000</u>	<u>\$ 4,569,774</u>	<u>\$ 395,000</u>

Revenue bonds consist of the following:

Water Fund

1999 Revenue Bonds – maturing \$110,000
to \$185,000 annually, plus interest from
4.75% to 5.10% through October 1, 2018

\$ 1,855,000

2002 Water Revenue Refunding Bonds – maturing
\$140,000 to \$190,000 annually, plus interest
from 3.00% to 4.00% through October 1, 2014

1,480,000
3,335,000

Sewer Fund

1992 Revenue Bonds – Michigan Municipal
Bond Authority Revolving Loan Fund payable,
maturing \$145,000 to \$165,000 annually,
plus interest at 2.00%, through April, 2013

1,080,000

\$ 4,415,000

Annual debt service requirements to maturity on the above governmental bond obligations are as follows:

	<u>Water</u>			<u>Sewer</u>		
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 250,000	\$ 137,189	\$ 387,189	\$ 145,000	\$ 21,600	\$166,600
2008	260,000	127,614	387,614	150,000	18,700	168,700
2009	270,000	117,696	387,696	150,000	15,700	165,700
2010	275,000	107,310	382,310	155,000	12,700	167,700
2011	290,000	96,132	386,132	155,000	9,600	164,600
2012 - 2016	1,455,000	286,725	1,741,725	325,000	9,800	334,800
2017 - 2019	<u>535,000</u>	<u>41,515</u>	<u>576,515</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>\$3,335,000</u>	<u>\$ 914,181</u>	<u>\$4,249,181</u>	<u>\$1,080,000</u>	<u>\$ 88,100</u>	<u>\$1,168,100</u>

Hillsdale Board of Public Utilities

Notes to Financial Statements

Note 6 - Employee Retirement System

Plan Description

The BPU, in conjunction with the City of Hillsdale, participates in an agent multiple-employer defined benefit public employee retirement system governed by the State of Michigan, titled Municipal Employees Retirement System (MERS). Information regarding this plan can be found in the City of Hillsdale annual financial statements.

Note 7 - Risk Management

The BPU is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets, errors and omissions, injuries to employees and natural disasters. The BPU carries commercial insurance to cover risks of losses. The BPU settled claims resulting from these risks did not exceed the amount of insurance coverage in any of the past three fiscal years.

Note 8 - Interfund Receivables and Payables

The composition of interfund balances at year-end is as follows:

Due To/From Other Funds of BPU:	<u>Receivables</u>	<u>Payables</u>
Water	\$ -	\$ 1,001,735
Sewer	<u>1,001,735</u>	<u>-</u>
	<u>\$ 1,001,735</u>	<u>\$ 1,001,735</u>
 Due To/From Other Funds of City:	 <u>Receivables</u>	 <u>Payables</u>
Electric	\$ 17,506	\$ 45,815
Water	-	2,530
Sewer	-	<u>2,946</u>
	<u>\$ 17,506</u>	<u>\$ 51,291</u>

The BPU reports interfund balances between many of its funds. The sum of all balances presented in the tables above agrees with the sum of interfund balances presented in the statements of net assets/balance sheet for the business-type activities. These interfund balances resulted primarily from the time lag between the dates that (1) interfund goods and services are provided or reimbursable expenditures occur, (2) transactions are recorded in the accounting system, and (3) payments between funds are made.

Supplemental Information

Hillsdale Board of Public Utilities
Electric Fund
Statements of Net Assets
June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Assets:		
Current assets:		
Cash and cash equivalents	\$ 1,372,143	\$ 1,606,645
Receivables (net of allowance for uncollectibles):		
Customer accounts	1,041,101	1,058,723
Interest	12,619	11,683
Due from City	17,506	5,498
Inventories	637,762	642,136
Prepaid expenses	<u>81,656</u>	<u>79,607</u>
Total current assets	<u>3,162,787</u>	<u>3,404,292</u>
Restricted and designated assets:		
Designated investments	<u>2,118,218</u>	<u>2,083,438</u>
Total restricted and designated assets	<u>2,118,218</u>	<u>2,083,438</u>
Capital assets:		
Property, plant and equipment, at cost	29,183,273	28,215,586
Less: accumulated depreciation	<u>16,955,419</u>	<u>16,337,476</u>
Total capital assets	<u>12,227,854</u>	<u>11,878,110</u>
Other assets:		
Investment in M.S.C.P.A.	<u>4,463,715</u>	<u>3,882,013</u>
Total assets	<u>21,972,574</u>	<u>21,247,853</u>

	<u>2006</u>	<u>2005</u>
Liabilities:		
Current liabilities payable from current assets:		
Accounts payable	\$ 63,964	\$ 33,659
Accrued purchased power	809,582	887,342
Due to City	45,815	22,890
Customer deposits	7,069	11,341
Payroll taxes	5,318	6,033
Other	<u>35,072</u>	<u>15,582</u>
 Total current liabilities	 966,820	 976,847
 Compensated absences	 <u>82,690</u>	 <u>77,298</u>
 Total liabilities	 <u>1,049,510</u>	 <u>1,054,145</u>
 Net Assets:		
Invested in capital assets, net of related debt	12,227,854	11,878,110
Unrestricted	<u>8,695,210</u>	<u>8,315,598</u>
 Total net assets	 <u>\$ 20,923,064</u>	 <u>\$ 20,193,708</u>

Hillsdale Board of Public Utilities
Electric Fund
Statements of Revenues, Expenses
and Changes in Net Assets
Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Operating Revenue:		
Sales to customers:		
Residential	\$ 3,245,416	\$ 3,075,167
Business	944,680	971,265
Commercial	2,556,697	2,430,498
Industrial	3,074,207	3,375,137
Street light sales	35,198	34,501
Other operating income	<u>40,211</u>	<u>36,450</u>
 Total operating revenue	 <u>9,896,409</u>	 <u>9,923,018</u>
Operating Expenses:		
Purchased power	6,604,746	6,329,230
Production expense	889,504	939,811
Transmission and distribution	995,361	979,595
Administrative and general	<u>752,007</u>	<u>843,752</u>
 Total operating expenses	 <u>9,241,618</u>	 <u>9,092,388</u>
 Operating Income (Loss)	 <u>654,791</u>	 <u>830,630</u>
 Non-operating Revenue (Expense)		
Interest income	71,761	76,921
Other non-operating income (expense)	<u>2,804</u>	<u>50,807</u>
 Total non-operating revenue (expense)	 <u>74,565</u>	 <u>127,728</u>
 Changes in Net Assets	 729,356	 958,358
 Net Assets, Beginning of Year	 <u>20,193,708</u>	 <u>19,235,350</u>
 Net Assets, End of Year	 <u>\$ 20,923,064</u>	 <u>\$ 20,193,708</u>

Hillsdale Board of Public Utilities
Electric Fund
Schedules of Operating Expenses
Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Purchased Power:		
Purchased power	\$ 9,973,942	\$ 9,163,137
Power cost adjustment	(2,787,494)	(2,156,253)
Gain on investment in M.S.C.P.A.	<u>(581,702)</u>	<u>(677,654)</u>
Total purchased power	<u>\$ 6,604,746</u>	<u>\$ 6,329,230</u>
Production Expense:		
Depreciation	\$ 238,376	\$ 249,963
Engine fuels	77,823	147,925
Production operation	505,986	433,454
Production maintenance	<u>67,319</u>	<u>108,469</u>
Total production expense	<u>\$ 889,504</u>	<u>\$ 939,811</u>
Transmission and Distribution Expense:		
Depreciation	\$ 324,331	\$ 298,818
Distribution operation	298,035	324,515
Distribution maintenance	<u>372,995</u>	<u>356,262</u>
Total transmission and distribution expense	<u>\$ 995,361</u>	<u>\$ 979,595</u>
Administrative and General Expense:		
Payment in lieu of tax	\$ 300,030	\$ 299,551
Depreciation	78,227	100,748
Customer accounts expense	71,938	79,006
Customer service and information expense	25,922	24,418
Administrative operation	267,784	335,530
Administrative maintenance	<u>8,106</u>	<u>4,499</u>
Total administrative and general expense	<u>\$ 752,007</u>	<u>\$ 843,752</u>

Hillsdale Board of Public Utilities
Water Fund
Statements of Net Assets
June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Assets:		
Current assets:		
Accounts receivable	\$ 69,506	\$ 75,920
Interest receivable	2,804	3,001
Inventory	80,122	85,051
Prepaid expenses	<u>20,177</u>	<u>17,627</u>
Total current assets	<u>172,609</u>	<u>181,599</u>
 Restricted and designated assets:		
Designated investments	234,959	231,379
Restricted investments	<u>633,871</u>	<u>619,884</u>
Total restricted and designated assets	<u>868,830</u>	<u>851,263</u>
 Capital assets:		
Property, plant and equipment, at cost	9,962,770	9,871,661
Less: accumulated depreciation	<u>(4,157,629)</u>	<u>(3,947,781)</u>
Total capital assets	<u>5,805,141</u>	<u>5,923,880</u>
Total assets	<u>6,846,580</u>	<u>6,956,742</u>

	<u>2006</u>	<u>2005</u>
Liabilities:		
Current liabilities payable from current assets:		
Accounts payable	\$ 9,825	\$ 9,658
Due to other funds of BPU	1,001,735	976,356
Due to City	2,530	2,716
Accrued liabilities	7,245	-
Customer deposits	<u>500</u>	<u>989</u>
Total current liabilities payable from current assets	<u>1,021,835</u>	<u>989,719</u>
Current liabilities payable from restricted assets:		
Bonds payable	250,000	245,000
Accrued interest	<u>35,476</u>	<u>37,592</u>
Total current liabilities payable from restricted assets	285,476	282,592
Compensated absences payable	35,148	29,593
Long-term debt, net of current maturities:		
Bonds payable	<u>3,085,000</u>	<u>3,335,000</u>
Total liabilities	<u>4,427,459</u>	<u>4,636,904</u>
Net Assets:		
Invested in capital assets, net of related debt	2,470,141	2,343,880
Restricted for debt service	633,871	619,884
Unrestricted (deficit)	<u>(684,891)</u>	<u>(643,926)</u>
Total net assets	<u>\$ 2,419,121</u>	<u>\$ 2,319,838</u>

Hillsdale Board of Public Utilities
Water Fund
Statements of Revenues, Expenses
and Changes in Net Assets
Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Operating Revenue:		
Sales to customers:		
Residential	\$ 451,790	\$ 452,157
Business	113,458	115,197
Commercial	215,425	205,617
Industrial	108,495	117,980
Apartments	220,589	211,968
Other operating income	<u>4,761</u>	<u>6,664</u>
 Total operating revenue	 <u>1,114,518</u>	 <u>1,109,583</u>
 Operating Expenses:		
Production expense	50,336	44,536
Purification expense	205,935	206,046
Distribution expense	399,876	314,451
Administrative and general	<u>223,519</u>	<u>236,543</u>
 Total operating expenses	 <u>879,666</u>	 <u>801,576</u>
 Operating Income (Loss)	 <u>234,852</u>	 <u>308,007</u>
 Non-operating Revenue (Expense):		
Interest income	16,567	21,802
Interest expense	(144,380)	(153,857)
Other non-operating income (expense)	<u>(7,756)</u>	<u>3,233</u>
 Total non-operating revenue (expense)	 <u>(135,569)</u>	 <u>(128,822)</u>
 Changes in Net Assets	 99,283	 179,185
 Net Assets, Beginning of Year	 <u>2,319,838</u>	 <u>2,140,653</u>
 Net Assets, End of Year	 <u>\$ 2,419,121</u>	 <u>\$ 2,319,838</u>

Hillsdale Board of Public Utilities
Water Fund
Schedules of Operating Expenses
Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Production Expense:		
Depreciation	\$ 11,699	\$ 7,670
Production operation	31,177	28,457
Production maintenance	<u>7,460</u>	<u>8,409</u>
 Total production expense	 <u>\$ 50,336</u>	 <u>\$ 44,536</u>
 Purification Expense:		
Depreciation	\$ 58,789	\$ 58,544
Chemical expense	44,239	36,729
Purification operation	86,813	91,008
Purification maintenance	<u>16,094</u>	<u>19,765</u>
 Total purification expense	 <u>\$ 205,935</u>	 <u>\$ 206,046</u>
 Distribution Expense:		
Depreciation	\$ 130,105	\$ 118,217
Distribution operation	85,469	80,981
Distribution maintenance	<u>184,302</u>	<u>115,253</u>
 Total transmission and distribution expense	 <u>\$ 399,876</u>	 <u>\$ 314,451</u>
 Administrative and General Expense:		
Payment in lieu of tax	\$ 30,190	\$ 29,190
Depreciation	9,255	9,176
Customer accounts expense	45,186	45,982
Customer service and information expense	13,347	11,727
Administrative operation	121,837	138,344
Administrative maintenance	<u>3,704</u>	<u>2,124</u>
 Total administrative and general expense	 <u>\$ 223,519</u>	 <u>\$ 236,543</u>

Hillsdale Board of Public Utilities
Water Fund
Schedule of Bonded Debt
June 30, 2006

Revenue Bonds - Series 1999

Date	Rate	Principal	Interest	Total
October 1, 2006	4.750%	\$ 110,000	\$ 45,347	\$ 155,347
April 1, 2007			42,734	42,734
October 1, 2007	4.750%	110,000	42,734	152,734
April 1, 2008			40,122	40,122
October 1, 2008	4.750%	115,000	40,122	155,122
April 1, 2009			37,391	37,391
October 1, 2009	4.750%	120,000	37,391	157,391
April 1, 2010			34,541	34,541
October 1, 2010	4.750%	130,000	34,541	164,541
April 1, 2011			31,453	31,453
October 1, 2011	4.750%	135,000	31,453	166,453
April 1, 2012			28,247	28,247
October 1, 2012	4.800%	140,000	28,247	168,247
April 1, 2013			24,887	24,887
October 1, 2013	4.875%	145,000	24,887	169,887
April 1, 2014			21,353	21,353
October 1, 2014	4.900%	155,000	21,353	176,353
April 1, 2015			17,555	17,555
October 1, 2015	5.000%	160,000	17,555	177,555
April 1, 2016			13,555	13,555
October 1, 2016	5.050%	170,000	13,555	183,555
April 1, 2017			9,262	9,262
October 1, 2017	5.050%	180,000	9,262	189,262
April 1, 2018			4,718	4,718
October 1, 2018	5.100%	185,000	4,718	189,718
Totals		\$ 1,855,000	\$ 656,983	\$ 2,511,983

Hillsdale Board of Public Utilities

Water Fund

Schedule of Bonded Debt

June 30, 2006

Revenue Refunding Bonds - Series 2002

Date	Rate	Principal	Interest	Total
October 1, 2006	3.000%	\$ 140,000	\$ 25,604	\$ 165,604
April 1, 2007			23,504	23,504
October 1, 2007	3.000%	150,000	23,504	173,504
April 1, 2008			21,254	21,254
October 1, 2008	3.000%	155,000	21,254	176,254
April 1, 2009			18,929	18,929
October 1, 2009	3.200%	155,000	18,929	173,929
April 1, 2010			16,449	16,449
October 1, 2010	3.450%	160,000	16,449	176,449
April 1, 2011			13,689	13,689
October 1, 2011	3.550%	170,000	13,689	183,689
April 1, 2012			10,672	10,672
October 1, 2012	3.625%	175,000	10,672	185,672
April 1, 2013			7,500	7,500
October 1, 2013	4.000%	185,000	7,500	192,500
April 1, 2014			3,800	3,800
October 1, 2014	4.000%	190,000	3,800	193,800
Totals		\$ 1,480,000	\$ 257,198	\$ 1,737,198

Hillsdale Board of Public Utilities
Sewer Fund
Statements of Net Assets
June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Assets:		
Current assets:		
Cash and cash equivalents	\$ 370,181	\$ 188,868
Accounts receivable	72,313	78,919
Interest receivable	4,346	4,346
Due from other funds of BPU	1,001,735	976,356
Inventory	6,577	4,444
Prepaid expenses	<u>32,892</u>	<u>30,603</u>
Total current assets	<u>1,488,044</u>	<u>1,283,536</u>
Restricted and designated assets:		
Designated investments	278,357	275,127
Restricted investments	<u>591,990</u>	<u>581,431</u>
Total restricted and designated assets	<u>870,347</u>	<u>856,558</u>
Capital assets:		
Property, plant and equipment, at cost	13,265,101	13,224,790
Less: accumulated depreciation	<u>8,899,369</u>	<u>8,742,581</u>
Total capital assets	<u>4,365,732</u>	<u>4,482,209</u>
Total assets	<u>6,724,123</u>	<u>6,622,303</u>

	<u>2006</u>	<u>2005</u>
Liabilities:		
Current liabilities payable from current assets:		
Accounts payable	\$ 18,519	\$ 7,954
Due to City	2,946	2,831
Accrued liabilities	<u>7,343</u>	<u>-</u>
Total current liabilities payable from current assets	<u>28,808</u>	<u>10,785</u>
Current liabilities payable from restricted assets:		
Bonds payable	145,000	140,000
Accrued interest	<u>6,100</u>	<u>6,800</u>
Total current liabilities payable from restricted assets	151,100	146,800
Compensated absences payable	36,936	33,032
Long-term debt, net of current maturities:		
Bonds payable	<u>935,000</u>	<u>1,080,000</u>
Total liabilities	<u>1,151,844</u>	<u>1,270,617</u>
Net Assets:		
Invested in capital assets, net of related debt	3,285,732	3,262,209
Restricted for debt service	591,990	581,431
Unrestricted	<u>1,694,557</u>	<u>1,508,046</u>
Total net assets	<u>\$ 5,572,279</u>	<u>\$ 5,351,686</u>

Hillsdale Board of Public Utilities
Sewer Fund
Statements of Revenues, Expenses
and Changes in Net Assets
Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Operating Revenue:		
Sales to customers:		
Residential	\$ 442,896	\$ 444,885
Business	109,287	112,201
Commercial	228,140	213,987
Industrial	135,059	141,467
Apartments	221,876	211,163
Other operating income	<u>14,577</u>	<u>28,397</u>
 Total operating revenue	 <u>1,151,835</u>	 <u>1,152,100</u>
 Operating Expenses:		
Sewer collection system expense	202,332	172,182
Treatment expense	508,912	612,074
Administrative and general	<u>241,364</u>	<u>250,552</u>
 Total operating expenses	 <u>952,608</u>	 <u>1,034,808</u>
 Operating Income	 <u>199,227</u>	 <u>117,292</u>
 Non-operating Revenue (Expense):		
Interest income	49,234	46,562
Interest expense	(23,700)	(27,199)
Other non-operating income (expense)	<u>(4,168)</u>	<u>(69,920)</u>
 Total non-operating revenue (expense)	 <u>21,366</u>	 <u>(50,557)</u>
 Changes in Net Assets	 220,593	 66,735
 Net Assets, Beginning of Year	 <u>5,351,686</u>	 <u>5,284,951</u>
 Net Assets, End of Year	 <u>\$ 5,572,279</u>	 <u>\$ 5,351,686</u>

Hillsdale Board of Public Utilities
Sewer Fund
Schedules of Operating Expenses
Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Sewer Collection System Expense:		
Depreciation	\$ 62,424	\$ 52,109
Collection operation	51,119	42,801
Collection maintenance	<u>88,789</u>	<u>77,272</u>
 Total sewer collection system expense	 <u>\$ 202,332</u>	 <u>\$ 172,182</u>
 Treatment Expense:		
Depreciation	\$ 85,992	\$ 198,031
Chemical expense	12,957	9,007
Treatment operation	278,378	263,417
Treatment maintenance	<u>131,585</u>	<u>141,619</u>
 Total treatment expense	 <u>\$ 508,912</u>	 <u>\$ 612,074</u>
 Administrative and General Expense:		
Payment in lieu of tax	\$ 34,951	\$ 34,575
Depreciation	8,373	8,291
Customer accounts expense	51,624	43,901
Customer service and information expense	12,474	11,140
Administrative operation	130,239	150,566
Administrative maintenance	<u>3,703</u>	<u>2,079</u>
 Total administrative and general expense	 <u>\$ 241,364</u>	 <u>\$ 250,552</u>

Hillsdale Board of Public Utilities
Sewer Fund
Schedule of Bonded Debt
June 30, 2006

Michigan Municipal Bond Authority - March 26, 1992

<u>Date</u>	<u>Rate</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
October 1, 2006			10,800	10,800
April 1, 2007	2.00%	145,000	10,800	155,800
October 1, 2007			9,350	9,350
April 1, 2008	2.00%	150,000	9,350	159,350
October 1, 2008			7,850	7,850
April 1, 2009	2.00%	150,000	7,850	157,850
October 1, 2009			6,350	6,350
April 1, 2010	2.00%	155,000	6,350	161,350
October 1, 2010			4,800	4,800
April 1, 2011	2.00%	155,000	4,800	159,800
October 1, 2011			3,250	3,250
April 1, 2012	2.00%	160,000	3,250	163,250
October 1, 2012			1,650	1,650
April 1, 2013	2.00%	165,000	1,650	166,650
Totals		<u>\$ 1,080,000</u>	<u>\$ 88,100</u>	<u>\$ 1,168,100</u>



August 3, 2006

Board Members
Hillsdale Board of Public Utilities
Hillsdale, Michigan

We have audited the financial statements of the Hillsdale Board of Public Utilities (the BPU) for the year ended June 30, 2006, and have issued our report thereon dated August 3, 2006. In planning and performing our audit of the general-purpose financial statements of the BPU, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the general-purpose financial statements and not to provide assurance on the internal control.

The Management of the BPU is responsible for establishing and maintaining effective internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control. The objectives of internal control are to provide the Board with a reasonable but not absolute assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with the Board's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles.

Because of the inherent limitations in any system of internal control, errors and irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our study and evaluations made for the limited purpose described in the first paragraph would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion of the system of internal accounting control of the BPU taken as a whole. However, our study and evaluation disclosed no conditions that we believe to be a material weakness.

Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under Generally Accepted Auditing Standards

As stated in our engagement proposal, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material errors, fraud, or illegal acts may exist and not be detected by us.

As part of our audit, we considered the internal control of the BPU. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

Our Responsibility under Generally Accepted Auditing Standards (Continued)

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the BPU's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the BPU are described in Note 1 to the financial statements. No new accounting policies were adopted and no other applications of existing policies were changed during the current year. We noted no transactions entered into by the BPU during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. There were no material estimates recorded in the current year.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the BPU's financial reporting process (that is, cause future financial statements to be materially misstated). There were no significant audit adjustments recorded at year-end.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the BPU's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

Comment and Recommendations

We found no significant issues that warrant comment or recommendation for change.

This information is intended solely for the use of the BPU Board and management of the BPU and is not intended to be and should not be used by anyone other than these specified parties.

We would like to thank the BPU and its staff for the cooperation extended to us during our audit and would be happy to discuss any of the comments in detail if you so desire.

Sincerely,

Willis + Jurasek, P.C.

Willis & Jurasek, P.C.